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UNCLAS SECTION 01 OF 02 TEGUCIGALPA 003023

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E.O. 12958: N/A

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SUBJECT: Upcoming IMF Mission: Civil Service Reform is
Number One Priority

REF: Tegucigalpa 3004

1. (SBU) The long awaited IMF mission (originally planned for February 2002 and delayed several times to give the Maduro team time to understand the inherited fiscal problems and develop plans to address them) will arrive on November 14. The mission is scheduled to conduct an Article IV review and discuss the potential outlines of a new three-year Poverty Reduction and Growth Facility program. Both the IMF resident rep and the Central Bank President have confirmed that the key issue is the uncontrolled increase in public sector salaries.

2. (SBU) The Fund will push hard for introduction and passage of a comprehensive civil service law that would provide the legal framework for having a sensible wage policy. Along with this provision, the IMF would like to see the GOH provide a plan for reducing the percentage that central government salaries represent of GDP (this has risen from 45 percent of GDP in 1997 to an estimated 67 percent in 2002). The IMF will also push for better tax collection and elimination of tax exemptions to help reduce the fiscal deficit in the short-run (see refetel for description of the problems in the country's tax policy).

3. (SBU) The IMF is emphasizing the civil service law (which was a prominent commitment in the GOH's earlier IMF program as well, but was never implemented) for two important reasons. First, the uncontrolled increase in the central government wage bill is leading to a fiscal imbalance of eventually crisis proportions. Second, the country badly needs institutional strengthening throughout the government and this can only be achieved with a strong legal framework creating a career civil service. The Interamerican Development Bank and World Bank reps here agree with the view that the Civil Service Law is a key policy change needed to control government expenditures and increase GOH effectiveness.

4. (SBU) We understand from other members of the donor community that the IMF mission may also push the GOH to develop a more realistic plan of social projects, as outlined in the Poverty Reduction Strategy Paper (PRSP). This would require revision of the PRSP (which has already been approved by Congress) with extensive consultation with civil society. The government clearly does not have the financial resources to comply with its commitments in the PRSP, in the current macroeconomic climate and without HIPC debt relief.

5. (SBU) Structural reforms, such as liberalization of the energy and telecommunications sectors, are not currently being discussed in the context of the IMF program. The Fund has decided to focus strictly on macroeconomic policy.

6. (SBU) The fragile financial sector continues to be of great importance in Honduras, but the GOH has complied with most of the conditions in the previous IMF plan and is acting responsibly in addressing this problem. The World Bank and IDB are continuing their work in the sector, including a full assessment of the financial sector, on-site reviews of each bank with subsequent development of action plans to ensure full compliance with regulatory requirements, and improvement in the legal framework to allow for strengthened supervision in the non-bank institutions.

7. (SBU) The IMF appears to be impressed with the political will in Maduro's team (primarily Banking Commission President Ana Cristina Pereira and Central Bank President Maria Elena Mondragon) to strengthen financial sector supervision and compliance with the Basel accords.

18. (SBU) The passage of legislation in July to reduce the cap on related lending from 120 percent of capital to 20 percent of capital within three years was viewed favorably by the IFIs. The decision to take over two banks in the spring (instead of liquidating them) was supported by the IMF because it reduced the up-front cost to the government. The Fund also was supportive of the decision to extend the 100 percent deposit insurance for another three years, to avoid a run on the smaller banks.

Palmer